

83-548

No.

IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1983

Office-Supreme Court, U.S.  
FILED

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ALEXANDER L. STEVAS,  
CLERK

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ANTHONY M. TORTORIELLO, HUGO UYTERHOEVEN,  
WALLACE J. STENHOUSE, JR., DONALD J. CLARKIN,  
STANTON I. SUBECK, JOHN W. MULDOON and  
MICHAEL L. MEYER,

*Petitioners,*

v.

JAMES W. SCHACHT, AS ACTING  
DIRECTOR OF INSURANCE OF THE  
STATE OF ILLINOIS AND LIQUIDATOR  
OF RESERVE INSURANCE COMPANY,

*Respondent.*

**PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**

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### QUESTION PRESENTED

The United States Court of Appeals for the Seventh Circuit affirmed an order of the district court, which denied petitioners' motion to dismiss certain claims against them brought pursuant to Title IX of the Organized Crime Control Act of 1970, entitled Racketeer Influenced and Corrupt Organizations ("RICO"), 18 U.S.C. §§ 1961-1968 (1970).

The Court of Appeals' decision presents the following question:

Whether Congress, in enacting RICO, intended (1) to federalize common law fraud, and (2) to provide a treble damage remedy for securities violations for which recovery heretofore has been restricted to actual damages.

**PARTIES BELOW**

The plaintiff in this cause is the Acting Director of Insurance of the State of Illinois, and Liquidator of Reserve Insurance Company ("Reserve"). Petitioners are the former directors and officers of Reserve and its parent, American Reserve Corporation ("ARC"). They are defendants and were appellants in the cause below. Other defendants are: a French reinsurance company and its American subsidiary; three public accounting firms which served as auditors of Reserve and/or ARC; two subsidiaries of ARC; and the former general counsel of Reserve.<sup>1</sup>

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<sup>1</sup>Specifically, petitioners' co-defendants below are (a) reinsurance companies: Societe Commerciale De Reassurance ("SCOR") and SCOR Reinsurance Company; (b) the public accounting firms of Arthur Andersen & Co., Coopers & Lybrand, and Alexander Grant & Company; (c) ARC subsidiaries: Guaranty Reinsurance Company and Reserve Insurance Managers, Ltd; and (d) Reserve's former general counsel, John J. Tickner.

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Petitioners Isidore Brown, Roger O. Brown, Jules Dashow, Walter Y. Elisha, Norman M. Gold, Jerrold N. Fine, Burton I. Koffman, Anthony M. Tortoriello, Hugo Uytterhoeven, Wallace J. Stenhouse, Jr., Donald J. Clarkin, Stanton I. Subeck, John W. Muldoon and Michael L. Meyer respectfully request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on April 8, 1983.

**OPINIONS BELOW**

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 711 F.2d 1343 (7th Cir. 1983). The Seventh Circuit's opinion appears beginning at page 1a



of the Appendix ("App."), which was submitted to this Court, on behalf of all petitioners, with the petition of Arthur Andersen & Co., Coopers & Lybrand, Alexander Grant & Company, Societe Commerciale de Reassurance and SCOR Reinsurance Company. The Court of Appeals' order denying rehearing and the orders of the district court, which are not reported, appear at pages 1b, 1c and 1d of the Appendix.

## JURISDICTION

The judgment of the Court of Appeals was entered on April 8, 1983. Petitioners' timely Petition for Rehearing and Suggestion for Rehearing En Banc was denied on July 1, 1983. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1976).

## STATUTORY PROVISIONS INVOLVED

Section 1961(1) of RICO, 18 U.S.C. § 1961(1) (1970), provides in relevant part that:

"Racketeering activity" means . . . (B) any act which is indictable under any of the following provisions of title 18, United States Code: . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud) . . . or (D) any offense involving . . . fraud in the sale of securities . . . .

Section 1962(c) of RICO, 18 U.S.C. § 1962(c) (1970), provides:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of an unlawful debt.



Section 1964(c) of RICO, 18 U.S.C. § 1964(c) (1970), provides:

Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

### STATEMENT OF THE CASE

This case presents the issue whether Section 1964(c) of RICO creates a federal cause of action for treble damages based on the routine use of the United States mails by a business entity to transmit audited financial statements, which are later alleged to have been deceptive.

Plaintiff James W. Schacht ("Schacht") is the liquidator of Reserve Insurance Company, which was declared insolvent in 1979. Schacht's RICO claims provide the sole basis of federal jurisdiction in this action. Schacht's RICO claims, in turn, are predicated upon allegations that the audited financial statements of Reserve and its parent, ARC, fraudulently understated the liabilities of Reserve and ARC, thereby concealing the companies' insolvency. The complaint alleges that, because of the purported fraud, Reserve continued to do business while insolvent and thereby further increased its indebtedness.

The Court of Appeals concluded that a complaint which alleges injury to a person "as a result of the defendants' direct or indirect participation in the conduct of [a business] affairs through alleged mail fraud" states a claim for relief under RICO. (App. at 16a.) The Court concluded that the necessary consequence of the purported mail fraud—Reserve's prolonged corporate existence—could constitute injury "by reason of a violation" of RICO, for which treble damages may be recovered.

The Court acknowledged that its decision "may well have created a runaway treble damage bonanza for the already excessively litigious." (App. at 36a.) In addressing defendants' argument that such a holding will create a federal cause of action for common law fraud, and permit recovery of treble damages for securities law violations, the Court of Appeals observed:

We agree that the civil sanctions provided under RICO are dramatic, and will have a vast impact upon the federal-state division of substantive responsibility for redressing illegal conduct, but like most courts who have considered this issue, we believe that such dramatic consequences are necessary incidents of the deliberately broad swath Congress chose to cut in order to reach the evil it sought; we are therefore without authority to restrict the application of the statute.

App. at 20a.

## **REASONS FOR GRANTING THE WRIT**

### **I. THE DECISION OF THE SEVENTH CIRCUIT PRESENTS A CRITICAL ISSUE OF FEDERAL LAW WHICH SHOULD BE RESOLVED BY THIS COURT.**

The decision of the Court of Appeals, if permitted to stand, will engulf claims for common law fraud and business misconduct, which previously have been confined to the jurisdiction of the state courts. The decision will also eviscerate restrictions on private claims brought under the federal securities laws.

The Seventh Circuit's decision that RICO "federalize[s] the common law of 'garden variety' business fraud" (App. at 20a) will affect every federal district court in this country. A RICO claim may be predicated, in part, on two acts of mail fraud. A mail fraud violation may be pleaded with simple allegations of (1) a scheme to defraud, and (2) the use of the mails in furtherance of the scheme. 18 U.S.C. § 1341 (1970).

There is virtually no common-law fraud claim that cannot be re-shaped to satisfy these simple pleading requirements. If, as the Seventh Circuit has concluded, RICO provides treble damages for injury which is the necessary consequence of mail fraud (for which, until now, federal courts have refused to imply a private remedy<sup>2</sup>), the variety of state law claims which will be escorted into federal court is limited only by imagination.<sup>3</sup>

The Court of Appeals' decision will have a similarly profound effect on private litigation under the federal securities laws, since it will be a rare securities fraud complaint that cannot allege at least two mailings or acts of fraud. The decision below extends RICO's private right of action to afford treble damages and attorney's fees for securities violations, for which an "actual damages" cap is established by statute.<sup>4</sup> Moreover, the Seventh Circuit's holding renders meaningless this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), which affirmed the time-honored rule that only purchasers or sellers of securities have standing to recover for securities fraud under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb

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<sup>2</sup> See, e.g., *Ryan v. Ohio Edison Co.*, 611 F.2d 1170, 1179 (6th Cir. 1979); *Bell v. Health-Mor, Inc.*, 549 F.2d 342, 346 (5th Cir. 1977).

<sup>3</sup> See, e.g., *Erlbaum v. Erlbaum* [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 98,772 at 93,919 (E.D. Pa. July 13, 1982) (RICO claim predicated on alleged fraud in connection with a marital property dispute); *Bays v. Hunter Savings Assoc.*, 539 F. Supp. 1020 (S.D. Ohio 1982) (alleging deceptive consumer lending practices by a bank); *Waterman Steamship Corp. v. Avondale Shipyards, Inc.*, 527 F. Supp. 256 (E.D. La. 1981) (RICO claims based on manufacture and sale of allegedly defective products).

<sup>4</sup> The Securities Exchange Act of 1934 provides that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb (1975). The statute includes no provision for recovery of attorney's fees. *Straub v. Vaisman & Co.*, 540 F.2d 591 (3d Cir. 1976).

(1975). A "*Blue Chip*" plaintiff who neither bought nor sold, and who thus had no claim under the federal securities laws, now need only assert that a defendant committed two mailings in furtherance of a scheme to defraud him into not buying or selling, and Section 1964(c) of RICO will afford him a federal treble damage remedy.

This Court has never addressed the scope of RICO's civil provisions. The Seventh Circuit's decision presents a crucial issue of federal jurisdiction which should be immediately resolved by this Court. The interpretation of RICO adopted below will cause an avalanche of litigation to descend on over-burdened district courts. Congress did not intend that result when it enacted RICO. This Court should grant certiorari and reverse the decision below.

## II. THE SEVENTH CIRCUIT'S DECISION REGARDING THE SCOPE OF RICO'S CIVIL PROVISIONS IS INCORRECT.

The Court of Appeals acknowledged the dramatic impact that its decision will have on the federal judiciary, but could formulate no "legitimate principled criterion" with which to determine whether a particular claim falls within RICO's intended scope. (App. at 26a.)

However, numerous courts have refused to permit exploitation of RICO's expansive language for purposes unrelated to those envisioned by Congress when it enacted the statute. Those courts have concluded that Congress did not intend RICO merely "to provide an additional remedy for an already compensable injury." *Johnsen v. Rogers*, 551 F. Supp. 281, 285 (C.D. Cal. 1982); *Harper v. New Japan Securities International*, 545 F. Supp. 1002, 1007-1008 (C.D. Cal. 1982) ("It is simply incomprehensible that a plaintiff suing under the securities laws would receive one-third the damages of a plaintiff suing under RICO for the same injury.")<sup>5</sup>

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<sup>5</sup> In *Dan River, Inc. v. Icahn*, 701 F.2d 278, 291 (4th Cir. 1983), the Fourth Circuit declined to address the scope of RICO's civil provisions. Nevertheless, it sharply criticized the increasing use of

(footnote continued on next page)

Accordingly, courts have demanded that plaintiffs seeking a recovery of treble damages under RICO allege and plead a distinctive injury caused by specific conduct which constitutes a violation of Section 1962 of RICO, and not merely by underlying acts of mail fraud or securities fraud. *Johnsen v. Rogers*, 551 F. Supp. 281 (C.D. Cal. 1982); *Harper v. New Japan Securities International*, 545 F. Supp. 1002 (C.D. Cal. 1982); *Erlbaum v. Erlbaum*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,772 at 93,922 (E.D. Pa. July 13, 1982); *Noland v. Gurley*, 566 F. Supp. 210 (D. Colo. 1983); *Richardson v. Shearson/American Express Co.*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,145 at 95,526 (S.D.N.Y. Mar. 29, 1983).

The Seventh Circuit rejected the conclusion that the language of Section 1964(c), which requires an allegation of injury "by reason of" a substantive RICO violation, requires pleading or proof of any distinctive injury. The Court of Appeals held that Schacht's allegation that Reserve's continued operation deepened its insolvency stated an injury compensable under Section 1964(c). (App. at 31a.)

The Seventh Circuit's decision sanctions the use of RICO to recover treble damages for injuries which are merely the result of alleged fraud. In both his RICO claims and his common law fraud claims, Schacht charges that the purported scheme to defraud was directed at Reserve, and that it was intended to conceal Reserve's insolvency and enable it to continue to operate while insolvent. (App. at 23f-27f; 40f-42f.) Reserve's "deepened insolvency" was the necessary consequence of the alleged fraud, and not the result of a distinctive RICO violation. In holding that Schacht's allegations of injury are sufficient to support a RICO claim, the decision below disregards Congress' intent to limit standing under Section 1964(c), and affords an abusive and duplicative

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(footnote continued from preceding page)

RICO "in cases far removed from the context which Congress had in mind when it enacted the statute."

remedy to persons alleging injury which RICO was not designed to redress.

### CONCLUSION

For the reasons stated above, this petition should be granted and a writ of certiorari to the United States Court of Appeals for the Seventh Circuit should be issued.

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Dated: September 29, 1983



**SEE COMPANION CASE**

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---

**REPLY BRIEF FOR PETITIONERS**

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The Petition for A Writ of Certiorari should be granted.<sup>1</sup>

1. Schacht makes no serious effort to dispute that the Seventh Circuit's interpretation of RICO will extend federal jurisdiction to virtually any claim of common law fraud accompanied by two mailings and will permit recovery of treble damages for securities fraud. Schacht concedes that the specific conduct of which he complains is "overstatement of reserves and falsification of financial statements, fake reinsurance, illegal dividends and systematic looting." If dissemination of purportedly false financial statements and distribution of illegal dividends is, as Schacht asserts, "the

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<sup>1</sup>The statement required by Rule 28.1 appears at page ii of the Petition for A Writ of Certiorari.

stuff of which civil RICO is made" (Opp. at 7),<sup>2</sup> the decision below will indeed, as the panel predicted, have a dramatic and untoward effect on the federal judiciary. (App. at 36a.) For that reason alone, this Court should grant certiorari and decide whether Congress intended RICO to extend federal jurisdiction over state law claims and to re-write the federal securities laws.

2. Schacht concedes that RICO's broad language invites exploitation by private litigants for whom the statute was never intended. However, he urges that the victims of unfounded RICO claims are adequately protected by the Federal Rules of Civil Procedure, "discovery rules and summary judgment procedures." (Opp. at 10.) Discovery rules and summary judgment procedures are not an appropriate substitute for construction of a statute to ensure that a potent private remedy is confined to those purposes for which Congress intended it. This Court has not abandoned that function when confronted with questions regarding the scope of private remedies under the federal securities laws or anti-trust laws. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). RICO's civil provisions present questions of greater consequence to private litigants than the questions addressed in those cases.

3. Schacht asserts that the opinion below is consistent with decisions of other Courts of Appeals, which have uniformly rejected all limitations on standing to sue under RICO (Opp. at 14-15). That assertion incorrectly represents the decisions of those courts. The Sixth Circuit, in *USACO Coal Co. v. Carbomin Energy, Inc.*, 689 F.2d 94 (6th Cir. 1982), concluded that a prior criminal conviction is not a prerequisite to civil liability under RICO, but the court did not address any question concerning limitations on standing to

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<sup>2</sup>"Opp." refers to Respondent Schacht's Brief in Opposition to the Petition for Certiorari.

sue by private plaintiffs. *Id.* at 95 n.1. Similarly, the sole issue addressed by the Eleventh Circuit in *Morosani v. First National Bank*, 703 F.2d 1220 (11th Cir. 1983), was whether conduct not traditionally subject to criminal prosecution could constitute a predicate act of racketeering. In *Moss v. Morgan Stanley, Inc.*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,478 at 96,750 (2d Cir. Sept. 9, 1983), the Second Circuit noted the decisions of "a growing number of courts that have limited standing under 18 U.S.C. § 1964(c) to those 'plaintiffs alleging something more, or different than direct injury resulting from the predicate acts that constitute the racketeering activity.'" *Id.* at 96,761-3 n.16, citing *Johnsen v. Rogers*, 551 F. Supp. 281, 284-85 (C.D. Cal. 1982). The panel in *Moss* declined to address that issue. Subsequently, however, in *Trane Co. v. O'Connor Securities*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,502 at 96,921 (2d Cir. Sept. 19, 1983), the Second Circuit expressed "... doubts as to the propriety of private party injunctive relief [under RICO], especially in a case of this nature alleging at most ... garden-variety securities law violations as predicates for the RICO violations." *Id.* at 96,923.



## CONCLUSION

The decision of the Seventh Circuit, if permitted to stand, will sanction the use of RICO's powerful treble damage provision in a manner never intended by Congress. Petitioners urge this Court to grant certiorari and review the decision below.

Respectfully submitted,

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